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SUBJECT: INDUSTRY AND REAL ESTATE POSSIBLE BUMPS IN
CROATIA'S ROAD TO THE EU

REF: ZAGREB 135

¶1. (SBU) Summary and Comment: EU accession is Croatia's top foreign policy goal and an area of unusual political consensus. After beginning negotiations in October 2005, the government of PM Ivo Sanader has set an ambitious goal of accession by 2009, in time to participate in European elections. Although most observers agree that such a timeline is optimistic, it is not discounted as altogether unrealistic. However, with only the initial screening process begun, tough negotiations on several sensitive issues lie ahead, such as weaning industry off of its habit of generous state subsidies and liberalizing the sale of land to foreigners. Both of these issues are likely to be highly politicized and could derail the promised accession timeline. Parliamentary elections due in late 2007 could also lead to deferring some difficult decisions. End Summary and Comment.

¶2. (SBU) The opening of EU accession negotiations on October 3, 2005 marked a major political and diplomatic victory for Croatian PM Sanader. EU membership enjoys broad support, both within the Croatian political class and among the general public, weathering even the highly unpopular arrest of ICTY fugitive Gotovina. Polling after the December 2005 Gotovina arrest showed support for EU membership in Croatia running at 57%, with approximately 38% opposed. However, public knowledge of the EU is scant and the government has been criticized for its lack of an effective public relations campaign to deepen public knowledge and support for the EU.

¶3. (SBU) Procedurally, Croatia's EU accession is still very much in its early stages. Croatian negotiating teams have been in Brussels for the initial "screening" of Croatian legislation against 11 of the 35 chapters of the EU "Acquis." The government, however, has set an optimistic timetable of concluding negotiations by 2008, with actual accession following in 2009 in time for Croatia to participate in European elections. As a matter of mechanics, this timetable may not be unrealistic. Actual "negotiations" on the individual chapters of the Acquis are set to begin this year and run concurrently with the initial screening of the remaining 24. Croatia has already been preparing itself for EU membership for several years. According to our Commission contacts, Zagreb is unlikely to face great difficulties in bringing the remaining areas of national legislation into agreement with the Acquis. However, a few pitfalls lie ahead that are likely to spark political divisions and be hugely unpopular with the public.

¶4. (SBU) EU accession is forcing Croatia to confront its long-standing practice of subsidizing industry, as well as the sensitive issue concerning the sale of land to

foreigners. Industrial subsidies consume an enormous part of Croatia's state budget - approximately 3.0% of GDP by most estimates. For the most part, these subsidies are directed at a few loss-making industries where the government is the primary shareholder and that still employ a large number of people. The industries soaking up the bulk of these subsidies are shipbuilding, metals, the national railroad and the national airline. Although the government has been under pressure for years from the IMF, World Bank and the EU to come up with a plan to sanitize these companies and wean them off public life support, no effort so far has resulted in a credible plan. Previous efforts to privatize some of the companies have met fierce resistance from unions and local politicians, invariably leading to a hasty retreat and yet another year of state support.

15. (SBU) As the popularity of Croatia as a tourist destination has increased over the last few years, so have fears that the country will lose control of what it views as its most valuable resource, its coast. Although foreign nationals can already purchase property in Croatia, they are not able to do so freely. Only nationals of those countries that have a reciprocal agreement with Croatia can purchase property and then only with the concurrence of the government. In most cases, such approval is forthcoming, but is slow and does not apply to all countries in the EU, most notably Italy. Certain types of property, such as "agricultural land" and many smaller islands are off limits altogether. Nevertheless, even with the limited supply of property available for purchase by foreigners, prices have soared in the last few years. Croats fear that a complete liberalization of property sales to other EU member state nationals with their much greater purchasing power will price them out of their own coast.

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16. (SBU) Politicians have already begun to tap into fears of how EU membership will affect Croatia. Neven Mimica, opposition parliamentarian, former Minister for European Integration and member of the multi-party parliamentary committee supervising EU negotiations told us with a note of irony that his own Social Democratic Party was now taking a much more nationalistic position on property sales than when it was in power just a few years ago. President Mesic has spoken out frequently on this issue as well, suggesting that coastal property remain in state hands and be given out only as lease concessions. Possibly acting in anticipation of this debate, the Sanader government recently announced proposals for the state to have the right of first refusal on the purchase of Croatia's many islands.

17. (SBU) Industrial policy and land sales are likely to be some of the most protracted aspects of Croatia's negotiations. Should they prove to be as inflammatory as most observers predict, it could not come at a worse time for the government. Not only will Croatia face parliamentary elections in 2007, but any final bid for EU membership will have to be put to a national referendum. Under current law, a referendum must win a majority of all eligible voters in order to pass. Already concerned that a vote on EU membership under those conditions could fail, the government has talked of introducing legislation to require only a majority of voters who turn out.

18. (SBU) These and other potential pitfalls of EU accession have the government nervous. Compounding this anxiety are calls from some EU members for a cooling off period on enlargement and fears that, if Bulgaria and Romania do not make their Jan 1, 2007 targets, Croatia will be delayed as well. Finally, there is the ever-present suspicion that other EU countries want to link Croatia's accession to that of the other states of the former Yugoslavia, a paranoia that was further stoked by calls for a free trade area in the Western Balkans (reftel).

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